

Report of the auditor-general to the Free State Legislature and the council on the Moqhaka Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Moqhaka Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Service charges

6. The municipality recognised income on the sale of electricity and water, which did not meet the recognition requirements in accordance with SA Standards of GRAP 9, *Revenue from exchange transactions* (GRAP 9), due to estimates being based on meters that were broken as well as incorrect readings being levied on consumer accounts in the current and previous financial year. I was unable to determine the impact on income from the sale of electricity and water as it was impracticable to do so. In addition, I was unable to obtain sufficient appropriate audit evidence for income from the sale of electricity and water as support for meter readings was not provided. I was unable to confirm the income from the sale of electricity and water by alternative means. Consequently, I was unable to determine whether any adjustments to income from the sale of electricity and water stated at R228 492 331 (2014: R205 855 375) and R81 562 097 (2014: R74 409 874), respectively, in note 25 to the financial statements were necessary.

Aggregation of immaterial uncorrected misstatements

7. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items making up the statement of financial position, statement of financial performance and the notes to the financial statements:
 - The municipality did not review the residual values and useful lives and perform an impairment assessment for movable assets at each reporting date in accordance with SA Standards of GRAP, GRAP 17, *Property, plant and equipment* (GRAP 17) and SA Standards of GRAP, GRAP 26, *Impairment of cash-generated assets* (GRAP 26). I was unable to determine whether any further adjustment relating to movable tangible assets stated at R17 146 973 (2014: R17 489 229) and depreciation stated at R4 722 505 (2014: R4 790 590) in note 11 to the financial statements was necessary.
 - Receivables from exchange transactions reflected as R94 408 325 were overstated by R12 422 465.
 - Inventory reflected as R11 798 416 was overstated by R7 417 951.
 - General expenses reflected in the statement of financial performance as R61 321 501 were understated by R5 336 103.

In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following item by alternative means:

- Other income of R8 714 643.

Qualified opinion

8. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Moqhaka Local Municipality as at 30 June 2015 and the financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Irregular expenditure

10. As disclosed in note 58 to the financial statements, irregular expenditure of R35 673 826 (2014: R185 771 193) was incurred, which was mainly due to non-compliance with supply chain management requirements in respect of procurement transactions.

Restatement of corresponding figures

11. As disclosed in note 52 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014-15 in the financial statements of the Moqhaka Local municipality at, and for the year ended, 30 June 2014.

Material losses

12. As disclosed in note 57 to the financial statements, material electricity and water losses to the amount of R39 138 380 (2014: R39 841 257) and R16 228 355 (2014: R15 819 911), respectively, were incurred as a result of line losses, tampering and theft.

Material impairments

13. As disclosed in note 4 to the financial statements, a provision for impairment of debtors amounting to R226 134 990 (2014: R205 168 671) has been made with regard to irrecoverable receivables from exchange transactions.

Additional matter

14. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure note

15. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

16. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather

evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas (KPA's) presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - KPA 1: Basic service delivery and Infrastructure Investment on pages xx to xx.
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the selected key performance areas are as follows:

KPA 1: Basic service delivery and infrastructure investment

Usefulness of reported performance information

22. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustment budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the objectives, indicators and targets in the service delivery and budget implementation plan, without adoption thereof by the municipal council. This was due to inadequate oversight by management.
23. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. Significantly important indicators in relation to water, sanitation, electricity and solid waste were not well defined.

Reliability of reported performance information

24. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to inadequate monitoring of the completeness of

source documentation in support of actual achievements and frequent review of the validity and accuracy of reported achievements against source documentation.

Additional matter

25. We draw attention to the following matter. Our conclusion is not modified in respect of this matter:

Achievement of planned targets

26. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance area reported in paragraphs 22 to 24 of this report.

Compliance with legislation

27. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

28. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
29. The performance management system and controls relating to the planning, monitoring, measurement, review and reporting, and the manner in which it is conducted, organised and managed, were not maintained as required by sections 38 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and municipal planning and performance management regulation 7.

Annual financial statements and annual report

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, and the supporting records were provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
31. The oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2013-14 annual report was tabled, as required by section 129(1) of the MFMA.
32. The annual performance report for the year under review did not include a comparison of the performance with the performance in the previous financial year, as required by section 46 (1)(b) of the MSA.

Audit committee

- 33. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).
- 34. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).

Human resource management and compensation

- 35. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of the MSA.
- 36. The competencies of the chief financial officer, head of supply chain, financial and/or supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels, as required by regulation 13 of the *Municipal regulations on minimum competency levels*.
- 37. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury, as required by regulation 14(2)(a) of the *Municipal regulations on minimum competency levels*.
- 38. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by regulation 14(2)(b) of the *Municipal regulations on minimum competency levels*.

Expenditure management

- 39. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
- 40. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

- 41. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Consequence management

- 42. Irregular expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
- 43. Unauthorised expenditure was not authorised through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

Internal control

44. I considered internal control relevant to my audit of the financial statements, the service delivery performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the service delivery performance report and the findings on compliance with legislation included in this report

Leadership

45. The leadership did not always take timely and adequate action to address weaknesses in the finance and supply chain management directorate due to lack of monitoring and supervision, which resulted in material corrections in the financial statements and non-compliance with applicable legislation.
46. The leadership did not take effective steps to ensure that there are consequences for poor performance and transgressions as none of the unauthorised, irregular and fruitless and wasteful expenditure incurred was investigated during the financial year.

Financial and performance management

47. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. The municipality did not assign enough staff members to ensure the financial statements were reviewed for accuracy and completeness. Support staff lack appropriate competencies. This resulted in many findings relating to incorrect disclosure and non-disclosure. In certain instances the municipality did not prioritise the submission of adequate supporting documentation and reply to audit queries during the audit. Certain material audit findings communicated to the municipality during the audit were addressed by management, which resulted in material adjustments to the financial statements.
48. The municipality did not always comply with applicable laws and regulations. No formal processes were in place to effectively monitor compliance with legislation, which resulted in many instances of reported non-compliance. There was also a lack of consequences where laws and regulations were not complied with.
49. Staff members involved in performance management did not gather appropriate supporting documentation for all reported targets. This was due to lack of appropriate competencies in performance management. Some of the information gathered could not be relied on due to inconsistencies identified.

Governance

50. The audit committee did not effectively discharge their oversight responsibilities as they did not review internal audit's quarterly reports on performance measurement. They did not submit an audit report to council explaining how they reviewed the municipality's performance management system.

Auditor-General

Bloemfontein

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

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